



TACIR *FAST FACTS*

- ***Total state and local taxes in Tennessee compared to personal income are the lowest in the nation and the second lowest per capita.****
- ***Nevertheless, Tennessee's sales tax burden is among the five highest in the nation.****
- ***In Tennessee, the lower your income, the larger the portion you pay in taxes and the smaller the portion you have left for necessities.***
- ***Grocery food is completely exempt from sales taxes in two southeastern states—Florida and Kentucky—Georgia and North Carolina have no state sales tax on food; two more contiguous states have lower rates on food—Missouri, and Virginia—and Mississippi has no local sales tax at all.***

* US Census Bureau.
<http://www.census.gov/govs/www/estimate99.html>.

The Sales Tax "Bite" in Tennessee Approaches One and One-half Times the National Average

Only four states rank higher for sales taxes compared to personal income—with a one-cent increase, that number could fall to two.

Compared to residents of other states, Tennesseans pay extremely low overall state and local taxes. No state ranks below Tennessee for total state and local taxes compared to personal income (based on the

latest data available for the 50 states).

Only Alabama had lower taxes per capita, but the difference for all state and local taxes combined was less than \$20, \$1,990 for Alabama compared with \$2,109 for Tennessee in 1999.

Despite having a low overall tax burden, however, Tennessee imposes an extremely high sales tax. In fact, raising it one penny would make the sales tax bite more than one and one-half times the national average.

A one-cent increase in the sales tax is frequently discussed as an option to resolve Tennessee's current budget dilemma. Certainly, with the lowest overall tax burden in the country, Tennessee can increase taxes and remain an extremely low-tax state. The question is whether the sales tax is the best way to do that. Four states have no sales taxes at all, neither state nor local. They are Delaware, Montana, New Hampshire and Oregon.

There are a lot of arguments for and against sales taxes. The arguments in relation to individuals are fairly easy to understand:

- In contrast to income taxes, with sales taxes you get to take 100% of your paycheck home. Maybe, but for how long? If you stop for groceries or gas on the way home, you'll leave more than just the price of those goods behind. In Tennessee, you'll leave quite a lot of sales tax.
- Unlike other taxes, with sales taxes, you have complete control over how much you pay—that is to the extent you have complete control over how much you spend.
- It's a flat tax; everybody pays the same rate. The rate you pay in the checkout line is the same regardless of the size of the paycheck in your pocket, but the size of the bite taken out of your paycheck by the sales tax increases as the size of your paycheck decreases. Compared to your income, the sales tax is not flat and cannot be made flat.

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Sen. Robert Rochelle, Chairman

Harry A. Green, Executive Director

Does a higher sales tax make sense for Tennessee?

Despite the arguing, most people agree on the basics: that the tax system should be ***fair, efficient, stable and accountable***. Can Tennessee's tax system, with such an extremely high sales tax, live up to those standards?

Fairness. Many people believe that the tax structure ought to be neutral in relation to income, that is the tax "bite" should be the same percentage for everyone. At the very least, it should not take a bigger bite percentage-wise out of smaller incomes. But the sales tax does exactly that because the smaller your income, the smaller the proportion you spend on untaxed goods and services.

Efficiency. Tennessee sales taxes are so high, many goods and services have been made exempt, and lots of sales have been driven out of state to the distinct disadvantage of Tennessee businesses and the overall Tennessee economy. Revenue losses from sales tax exemptions are estimated in the Governor's budget document at two billion dollars for the fiscal year 2002-03, and that figure doesn't tell the whole story. In addition to the exemptions, there are losses because of the shift to spending more on services and less on taxable goods, and as sales tax rates continue to rise in Tennessee, more and more sales are shifting out of state. Economists at the University of Tennessee have estimated the annual *increase* in those losses at \$450 million. It's hard to call a tax structure with losses like those efficient.

Stability. Sales tax collections rise and fall with the economy more than collections based on income and property values. Taxing purchases of necessities like food, which don't fluctuate as much as the overall economy, helps minimize the downswings by providing a base. However, relying too heavily on taxing necessities increases the relative burden born by low-income families and prevents the tax system from growing with the economy.

Accountability. The biggest accountability problems stem from efforts to avoid Tennessee's high sales taxes by shopping in other states, whether by driving across the border, by telephone or mail, or via the Internet. A smaller problem is buying "off the books". In any case, you still owe the tax because it's a sales *and use* tax, but few people volunteer to pay it.

These are the issues with which legislators grapple as they work to resolve the current state budget impasse.

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Related Publications

Family Tax Burdens in Tennessee, A Comparative Analysis, Harry A. Green and Cliff Lippard, TACIR (July 1996).

The Budget, Fiscal Year 2002-2003, Don Sundquist, Governor

Tennessee Summary, State and Local Sales Tax Revenue Losses from E-Commerce: Updated Estimates, Donald Bruce and William F. Fox, University of Tennessee Center for Business and Economic Research (October 2001).

E-Commerce in the Context of Declining State Sales Tax Bases, Donald Bruce and William F. Fox, *National Tax Journal*, Vol. 53, No. 4 (December 2000).



TACIR (02/02); Pub. Auth. No. 316339; 3,840 copies. This public document was promulgated at a cost of \$0.09 each.

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Intergovernmental Relations
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